

Broker Self- Assessment Outreach Pilot

Report of Pilot Assessment

March 1, 2011

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Executive Summary

Broker Self-Assessment Outreach Pilot

The concept of a voluntary partnership with the customs brokerage community was tested during the one year Broker Self-Assessment Outreach Pilot (BSA), which began July 2009. The primary goal of the program was to facilitate a higher level of broker compliance with U.S. Customs and Border Protection (CBP) laws and regulations. This broker compliance self-assessment pilot was a collaborative effort between CBP and the National Customs Brokers and Forwarders Association of America (NCBFAA). CBP is strongly committed to encouraging members of the trade community to meet the responsibilities of complying with applicable trade laws and regulations.

CBP and the customs brokerage community sought to model the pilot after the existing Importer Self-Assessment (ISA) program, which is based on the premise that importers with internal controls in place achieve the highest level of compliance with CBP laws and regulations. Furthering cooperative relationships between CBP and participating customs brokers in order to support the accomplishment of our strategic trade goals just seemed to make sense. Customs brokers serve as intermediaries between CBP and the trading community and, as such, are a linchpin in the trade flow. The question becomes, "How can their participation be innovatively tapped to strengthen trade compliance?"

The pilot was successful in that it was effective in revealing several key factors that would be useful in making a decision whether to commit CBP resources to pursue such a partnership with customs brokers. Four out of twenty-seven broker applicants were selected to participate in the pilot based on CBP and the NCBFAA's desire to have brokerages that represented small, medium, and large volume of activities.

A significant amount of work hours were expended by CBP towards data gathering, analysis, strategizing, meeting with each applicant, and post analysis relative to the amount of value added for both CBP and the broker. Both CBP and the trade experienced some challenges in the interpretation of the partnership intent and translating that into pilot implementation. It is also important to highlight that each of the broker participants devoted a noteworthy amount of resources, working independently and in tandem with CBP, preparing for its internal control assessment.

Brokers themselves admitted that they were limited in ensuring that import transactions would be highly compliant even though their internal controls over their customs operations (19 C.F.R. 111 activities) may demonstrate a high level of compliance. The brokers participating in the pilot, and the NCBFAA at large, have stated that brokers are data transmitters and should not be held liable for "importer of record" responsibilities under the law and regulations; albeit prudent brokers review and may question transactions.

Since CBP cannot directly correlate the body of work performed in evaluating a broker's internal controls over its customs business into a mitigating risk factor that would facilitate the flow of legitimate trade, then the BSA program as piloted would not prove a wise deployment of resources for CBP and/or the brokerage community. This report recommends that the BSA pilot end without a plan to proceed with another ISA-type model at this time. CBP has agreed with the NCBFAA to pursue other avenues to collaborate pertaining to trade modernization efforts.

Purpose of Report

This report has been prepared to assess the concept of broker self-assessment as a potential partnership program between the brokerage community and CBP. The Agency must determine whether this program is a viable program for CBP to pursue and dedicate resources with the goal of yielding benefits to both CBP and the brokerage community. The contents of this report will help in the decision-making process of whether or not to adopt this partnership program as tested in the pilot. The recommendation of this report will be presented to the International Trade Modernization Board for final decision.

Background

Problem Statement

The CBP trade strategy calls for increased partnership with not only other agencies, and other governments, but the trade community as well. CBP examined gaps that were in its outreach and partnership initiatives, along with how it might increase its visibility and risk management efforts. A formal partnership with customs brokers focusing on trade compliance had not previously been pursued.

Overall Goal of Pilot Outreach Program

The primary goal of the pilot program as stated in the April 27, 2009 Federal Register Notice announcing the commencement of the pilot was to facilitate a higher level of broker compliance with CBP laws and regulations. It was surmised that this program could facilitate legitimate trade so that CBP could focus on higher-risk trade enforcement issues. It was anticipated that the pilot participants would update and improve their internal controls, establish periodic testing of these internal controls, and disclose to CBP deficiencies discovered through this testing. The pilot program would allow for customs brokers to ascertain voluntarily with CBP how well they comply with their broker requirements and provide recognition and support to participating brokers.

Development/Delivery of Pilot Outreach Program

There were basic requirements for pilot participation, among which was Customs-Trade Partnership Against Terrorism (C-TPAT) membership. Twenty-seven brokers applied and four were selected based on CBP and the NCBFAA's desire to have brokerages that represented small, medium, and large volume of activities.

The seven-person Office of International Trade BSA workgroup drafted working program documents, with input from the NCBFAA BSA subcommittee, such as the memorandum of understanding, questionnaire, and handbook. After eight months of internal planning, strategizing, and data collection, the first BSA pilot Application Review Meeting (ARM) was conducted in February 2010. The second ARM was conducted in May 2010, the third in June 2010, and the fourth in July 2010.

The working group also drafted the account management standard operating procedures (SOP) for the BSA pilot program. Regulatory Audit (RA) working group members developed a technical guide for the program which was reviewed and accepted in draft form by the working group. The information gained from the four BSA pilot evaluations will be used to finalize the technical guide if the program is implemented. Pending implementation, the final technical guide will be completed on or about December 1, 2010 in accordance with the original planning.

Challenges

CBP experienced several challenges in the process of translating the intent of piloting this partnership initiative into its actual implementation.

- Upon review of the first prepared broker profile in October 2009, the working group determined it was not useful as formatted. The broker profile had to be re-worked from its original design.
- The RA evaluation team raised concerns regarding an applicant's understanding on the elements of effective of internal control as defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). These elements provide a framework for describing and analyzing the internal control system implemented in an organization as required by financial regulations. As a result of this lack of understanding, applicants did not provide sufficient responses or explanations of their internal controls in October 2009. The RA evaluation team held discussions via conference calls and emails with the BSA working group, Partnership Programs Branch (PPB), and RA HQ to determine whether the team should proceed with the evaluation and conduct the ARM. It was ultimately decided by PPB and the entire working group that the since this was a pilot program, the RA evaluation team should afford the applicant the opportunity to present their internal controls at the ARM. Lessons learned from the experience were to be used for future evaluation. This occurred prior to the first broker being notified of its ARM on January 11, 2010.
- The RA evaluation team contacted RA HQ and PPB and communicated the need to provide the first candidate more information on internal controls. The RA evaluation team suggested modifying the ARM confirmation letter by attaching appendices from the draft BSA handbook relating to internal controls. This was also discussed with members of the working group and ultimately agreed.
- In order to meet the Federal Register Notice requirement that the pilot be assessed by the end of June 2010, RA decided to allocate additional resources and assign BSA evaluations to two field offices.
- The BSA working group and RA evaluation team members made recommendations on improving the applicants vetting process to include a formal review by the Broker Compliance Branch. This was expressed to PPB in several conference calls and emails and ultimately resulted in the development of a template broker management clearance checklist. This was drafted in coordination with the broker management office in Newark, New Jersey.
- There was a need to change the RA work plan objectives based on input from the Assistant Commissioner, Office of International Trade in March 2010, and again after discussions with PPB while drafting the first BSA report.

Snapshot of Milestone Dates

| Broker | BSA Pilot Selection Notification | Questionnaire Received by PPB | RA Received Broker's Application | RA Notified Broker | ARM |
|----------|----------------------------------|-------------------------------|----------------------------------|--------------------|----------|
| Broker 1 | 07/17/09 | 10/09/09 | 10/13/09 | 01/11/10 | 02/09/10 |
| Broker 2 | 07/17/09 | 10/07/09 | 01/05/10 | 04/21/10 | 05/26/10 |
| Broker 3 | 07/17/09 | 08/28/09 | 01/05/10 | 04/20/10 | 06/23/10 |
| Broker 4 | 07/17/09 | 08/14/09 | 01/05/10 | 04/29/10 | 07/13/10 |

Types of Data Collected for the Profile

A profile was prepared for each of the BSA pilot candidates, which included each broker's transaction history going back at least three years. The profile included port activity, penalty actions against the broker, late duty payment, entry information, and prior audits. Risk management principles mandate the collection of data and information, subsequent analysis of the data, and the assessment of risk for any non-compliant patterns detected.

BSA Evaluation Team Work Performed

The following processes for which the broker participated in were examined: periodic monthly statement, bonded warehouse, importer security filings; remote location filing, and drawback. RA performed non-audit service assessments of the brokers' readiness to assume the responsibilities of the BSA pilot through an evaluation of the brokers' internal controls for achieving compliance with CBP laws and regulations. RA reported the results to the Trade Policy and Programs Directorate. To accomplish this, the RA evaluation team performed the tasks listed below.

- Evaluated the BSA Pilot application which included the Partnership Agreement, response to the BSA questionnaire, internal controls manual and organization chart.
- Held strategy meetings with the BSA Review Team.
- Analyzed the BSA Profile which included the national account manager's risk assessment.
- Analyzed the RA Automated Data Extract System (RAADES) information.
- Selected about five entry transactions based on identified risk factors for a "walk-thru" of the broker system used to process entries.
- Conducted an ARM with the company to:
 - assess the CBP-related policies and procedures;
 - observe the processes and review the supporting documentation for the selected entry transactions and evidence of implemented internal controls;

- review the applicants self-testing plan for adequacy and effectiveness; and
- gain an understanding of the operating procedures.

Staffing Resources

BSA Pilot Working Group Participants:

| Office of Int'l Trade | Position/Title | Grade |
|---------------------------------------|-------------------------------|-------|
| Trade Facilitation and Administration | Branch Chief (1) | 14 |
| | Program Manager (1) | 14 |
| | National Account Manager (2) | 13 |
| Regulatory Audit ¹ | Assistant Field Director (2) | 14 |
| | Senior Auditor (1) | 13 |
| | Computer Audit Specialist (1) | 13 |

They worked full-time during three one-week sessions, at their duty stations, and numerous 4-6 hour conference calls.

BSA (RA) Pilot Evaluation Team:

| | | |
|---------------------------------------|--------------------------|----|
| Regulatory Audit | Assistant Field Director | 14 |
| | Senior Auditor | 13 |
| | Auditor | 12 |
| Trade Facilitation and Administration | National Account Manager | 13 |

They worked full-time on the four broker self-assessment candidates.

Evaluation Goals

What questions are being answered by the evaluation?

The goal of this evaluation is to determine:

- 1) Are the resources expended commensurate with the potential gains to CBP and the broker?
- 2) Are there mutual benefits for CBP and the broker that would make this an attractive program?
- 3) Was the intent of the pilot realized through this pilot design?

¹ Regulatory Audit Ft. Mitchell and New York Field Offices.

Evaluation Results

Regulatory Audit Conclusions

Draft results based on the application review meetings conducted were prepared by Regulatory Audit. A summary of the results are as follows:

Overall, the BSA evaluation team found that the pilot candidates were prepared and had sufficient information on-hand to demonstrate the design of the internal controls over their customs operations. The commonality with all of the candidates was their attention to actions, plans, and values that set the tone of the control environment. This demonstrated management's commitment to ensuring that the broker's exercised supervision and control over customs transactions. Furthermore, the participants had gone to great lengths to document their system of internal controls to demonstrate to the evaluation team. While the controls may have been implemented, the procedures were not always formalized, and some cases the procedures were modified/improved but not yet implemented. Several of the candidates stated that the development of the procedures manual was an awakening moment, as much was revealed on how to better manage or mitigate risk factors.

The pilot also disclosed that the broker's assessment of risk factors differed somewhat to the ones CBP identified as potentially significant risks. All of the broker candidates agreed that the process assisted them in identifying some areas of risk that they previously had not considered. The evaluation team helped to fine-tune some control points to mitigate risks.

The pilot confirmed that there exists a profound limitation to the assurance that import transactions would be compliant based solely upon the broker's internal controls. The broker's submission is only as reliable and accurate as the information it is provided. The burden still rests on the importer to file accurate and correct information with CBP.

The BSA team did reveal that their experience with the first broker reviewed was not as harmonious and systemic because it was a learning curve and the auditors learned from that experience and modified their approach with the other three candidates. The time and resources allocated to the BSA pilot was reduced by nearly half after the first review.

Broker Participants' Feedback

Each BSA candidate received a short post evaluation questionnaire designed to obtain their comments on the BSA review process and suggestions regarding possible program implementation. As of the writing of this report, CBP received feedback from three of the four brokers. The questions and combined responses are as follows:

1. What is your overall assessment of the process/tone of the Application Review Meeting?

The candidates stated that the pre-meeting discussion and materials was very helpful and provided clear expectations for the ARM.

2. Were major changes in your operating and internal control procedures required to meet the perceived goals of the BSA Pilot?

The candidates reported that they did not make major changes to meet the perceived goals of the BSA pilot. One reported that some action was required to formalize some existing procedures.

3. *How much time and resources was devoted to prepare for the Application Review Meeting?*

Three broker candidates reported significant time, resources and money were expended to prepare for the ARM.

Broker 1: Allocation of resources commenced one year prior to the actual meeting, starting with the BSA pilot application, i.e., response to the questionnaire, develop presentations, and standardize procedures. A total of 13 team members (including executive and senior managers) and additional support staff assisted in the process.

Broker 2: Devoted much time, resources and money to the BSA ARM, this included the travel expenses for 9 employees to travel to Seattle. From the time of the engagement letter (from RA) about 1-4 hours per business day/per employee was spent preparing for the ARM. A total of 17 employees participated in the ARM.

Broker 3: Estimated that about 250 hours were expended in preparation for the ARM.

4. *Did the cost (resources, time, etc.) related to the BSA application process justify the potential future advantages of a BSA program?*

One broker indicated it devoted significant time, resources and money to the BSA Pilot application process and decided that the investment in the pilot was worthwhile based on potential benefits. However, another reported that since it is not fully aware of the complete scope of participant benefits, it could not provide a reasonable impression regarding the potential future benefits.

5. *What would you like to see improved, changed, added, or removed pertaining to the following:*

a. *Participation Requirement?*

Broker candidates reported that the requirements as stated in the Federal Register Notice, were straightforward and required no changes.

b. *Application Package?*

One broker reported that a pre-ARM could have been arranged to conduct a transactional testing and the ARM could have been reserved for high-level internal controls review. The other brokers responded that changes were not needed and the process was clear and straightforward.

c. *Application Review Process?*

One broker commented that the subsequent questionnaire provided by the review team assisted them greatly in determining the areas that the company should focus on and provided guidance on the type of information required for the review. Another broker commented on the difficulties in determining the best approach.

d. *BSA Program Advantages?*

One broker commented on the desire to see the initially proposed benefits regarding expedited processing of ruling requests and drawback applications. Also, a respondent mentioned the advantage of having an empowered, assigned national account manager to interface with directly to address national issues and ensure uniform trade practices across the ports. Another broker commented on the negating or mitigating factor to be applied to any contemplated penalties.

6. *Should the BSA program be adopted:*

a. *What are some challenges or vulnerabilities that may be encountered during CBP's oversight of the program?*

All of the respondents commented that some of the challenges may stem from the varying size and scope of the brokerage firm.

b. *What would you foresee as a reasonable participation re-evaluation interval?*

Two companies stated that a reasonable re-evaluation interval for participants would be every five years and the other stated three years, absent any significant operational changes.

National Customs Brokers and Forwarders Association of America Comments

The NCBFAA provided "One-Year Anniversary" comments on the BSA Pilot, submitted by its Customs Committee. The NCBFAA Customs Committee formed a BSA subcommittee in 2008 to work with CBP to establish this partnership program. The NCBFAA envisioned the BSA program as an opportunity to both demonstrate a commitment to compliance and create a new paradigm for CBP enforcement authority under 19 U.S.C. 1641. The Association felt that CBP would benefit from gaining a better understanding of customs broker business processes and lead to an alternative compliance verification methodology.

The Association states that a challenge arises in the translation of these motivations into a formal program. They view it as a two-part process whereby:

1. An investigative approach is employed by CBP to map the customs broker's business processes into a comprehensive compliance regime. Documentation, controls, and management are examined and a template created.
2. CBP verifies conformity of execution to plan and overall efficacy in an operational setting.

They observed the BSA pilot demonstrated that business profiles and process management within the brokerage business are highly diverse. In their opinion, standard templates are unlikely to emerge so that the degree of customization necessary for effective program management by both CBP and the brokerage community will be enormous. Subjecting already highly compliant companies to intense audit-type scrutiny without an extraordinary upside benefit is not an attractive option.

Their conclusion is that it is unlikely that without an overhaul of the current Fines Penalties and Forfeiture review process at the ports and imposition of a holistic evaluation prior to penalty assessment, that CBP will be able to associate sufficient benefits with the BSA program to overcome the unappealing nature of initiation. Further, the Association feels that it is equally unlikely that CBP can demonstrate

sufficient resource liberation and redeployment by creating a low risk BSA group to offset the resource intensive program management for such a diversified community as the brokerage community represents. As crafted with the pilot, the NCBFAA would not recommend a second BSA pilot based on the same or similar precepts and usages.

Limitation of the evaluation

There was not ample opportunity within the cycle time to launch and implement the pilot to perform a meaningful quantitative analysis to possibility determine impact on transactions. Also, the pilot participants did not have sufficient time to cycle through its developed self-testing plans.

Interpretations and Conclusions

The primary goal of the BSA Pilot Outreach was to facilitate a high level of broker compliance with CBP laws and regulations. It was surmised that this program could facilitate legitimate trade so that CBP could focus on higher-risk trade enforcement issues. It was envisioned that the pilot participants would update and improve their internal controls, establish periodic testing of these internal controls, and disclose to CBP deficiencies discovered through this testing. The reliable quantitative measure related to import transactions is the compliance measurement rate. However, it does not necessarily correlate with demonstrated compliance on the part of the broker. Brokers do not wish to be directly associated with (especially negatively) the compliance measurement rate, which primarily measures compliance in areas such as, classification, valuation, free trade agreement, anti-dumping and countervailing duty, etc. Further, there was not ample time to make a meaningful comparative measure of broker performance indicators (such as, number of rejects) to determine relative change.

The BSA evaluation team's assessment of the broker's internal control for achieving compliance with Title 19 CFR 111, concluded that three of the four participants demonstrated a strong commitment to ensuring compliance, professional ethics and professional development of their employees to meet its overall objective in regards to broker oversight and management controls. Three of the four participants provided exemplary documentation to support their processes, which validated the assertions made as to the significant resources allocated in preparation for the team's assessment.

If this partnership initiative were to proceed, relevant, measurable goals would need to be established to truly assess the impact of the program.

Recommendations

It is recommended that the BSA pilot end without a plan to proceed with another ISA-type model at this time. CBP has agreed with the NCBFAA to pursue other avenues to collaborate pertaining to trade modernization efforts.